

## EXAMINATION CONCEPTS AND GUIDELINES

### OVERVIEW

This section explores the rationale for compliance and Community Reinvestment Act examinations, concepts regarding examinations, and information resources available to examiners.

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### RATIONALE

The Division of Compliance and Consumer Affairs (DCA) has completed an aggressive effort to re-engineer the examination process to:

- Improve examiner efficiency
- Reduce examination presence in the financial institution
- Promote consistent examination standards and procedures
- Improve the quality of the examination process
- Improve the Report of Examination

The results of the re-engineering effort are evidenced in the revision of the Compliance Examination Manual. This manual is intended to provide examiners with user-friendly procedures and a compliance/CRA reference guide. This manual should not be viewed as a replacement for the FDIC Rules and Regulations, but rather as a supplement.

Congress by statute has assigned the FDIC enforcement responsibilities for various consumer protection, fair lending, and certain other regulations for financial institutions supervised by the FDIC. The compliance/CRA examination is the primary means by which the FDIC determines the extent to which a financial institution is meeting its responsibility to comply with the

**RATIONALE  
(cont'd)**

various requirements and proscriptions of the different laws and regulations. The compliance enforcement responsibilities assigned to the FDIC are similar to those responsibilities assigned to the FDIC in other areas, for example, to examine and supervise financial institutions for safety and soundness purposes, maintain deposit insurance funds, act as receiver, and liquidate the assets of failed financial institutions. All are tasks assigned by statute, and all must be performed in an efficient and consistent manner.

There are also a number of collateral reasons for effective enforcement of the various consumer laws and regulations. It is important that consumers and businesses obtain the benefits and protection afforded them by the laws and regulations. The compliance examination, and follow-up supervisory attention accorded violations and other deficiencies, helps to assure this result. In addition, violations of many of the laws and regulations give rise to possible civil liability for damages, and administrative adjustments for understated finance charges or annual percentage rates. Thus, violations can adversely impact the capital position of a financial institution. Therefore, to the extent that effective examination and supervision helps to identify violations, and preclude or minimize their recurrence, such adverse impact is avoided and the FDIC's safety and soundness objectives are met. Finally, the presence of violations and the absence of an effective program to manage a financial institution's compliance responsibilities, reflects adversely on senior management and the board of directors. This may well carry over into other areas of management responsibility.

The goal of the examiner is to ascertain the effectiveness of the institution in complying with consumer and fair lending laws and regulations the FDIC is charged with enforcing. Examiners should take a reasoned, common sense approach to examining that is based on cooperation with financial institution management to attain the goal of institution compliance with the laws and regulations. This section of the manual will provide the framework for conducting compliance/CRA examinations, but by no means can every variable or situation that must be analyzed when examining a financial institution be addressed in this section or any other section of this manual. However, baseline analysis procedures to be performed when conducting every examination have been established.

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## EXAMINATION PRIORITIES AND FREQUENCY CRITERIA

The FDIC's first priority continues to be the effective surveillance and supervision of those financial institutions requiring special supervisory attention. Implementation of this fundamental principal of targeting examinations and supervisory efforts where the need is greatest demands appropriate resource allocation and will be accomplished in accordance with the instructions set forth below. Since decisions concerning examination priorities and frequencies, as well as the supervisory steps taken subsequent to an examination, are significantly influenced by the consumer compliance and CRA ratings assigned, their importance is self-evident.

### Frequency

**Compliance** examinations should generally be conducted concurrently with safety and soundness examinations except when the size and arrangement of departments or other factors makes it impractical or inefficient to do so. Also, institution management requests that examinations be conducted separately should be considered in this determination.

However, when the safety and soundness composite rating is "1", "2", or "3" and the compliance area is rated "4" or "5" a compliance examination is to be conducted within a 12 month interval. Conversely, if the safety and soundness rating is "3", "4", or "5", the compliance examination may be extended to the maximum interval if the compliance area is assigned a compliance rating "1", "2", or "3".

Otherwise, the compliance examination frequency must conform to the standard examination intervals listed in the table following even when the safety and soundness examination has been extended. Asset size is determined by the last examination. However, if an institution experiences substantial growth from a merger or acquisition of assets or other reasons, this would impact the frequency schedule.

Compliance Composite Rating	Maximum Interval (Months)	
	Under \$250 Million	Under \$100 Million
1	36*	36*
2	24	36*
3	24**	
4	12	
5	12	

\* Interim Monitoring Procedures performed at 18 months

\*\* Mandatory visitations will be performed for all composite compliance "3" rated institutions within 12 months of the compliance examination start date.

## EXAMINATION PRIORITIES AND FREQUENCY CRITERIA (cont'd)

### Frequency (cont'd)

*NOTE: Institutions rated "1" or "2" with assets greater than \$250 million will have a maximum interval of 24 months.*

**Community Reinvestment Act (CRA)** examinations are, as a rule, conducted simultaneously with compliance examinations. The standard interval for CRA examinations is as follows.

COMMUNITY REINVESTMENT ACT	Maximum Interval (Months)	
	Under \$250 Million	Under \$100 Million
Rating		
Outstanding	36*	36*
Satisfactory	24	36*
Needs to Improve		12
Substantial Noncompliance		12

\* Interim Monitoring Procedures performed at 18 months

*NOTE: Institutions rated "Outstanding" or "Satisfactory" with assets greater than \$250 million will have a maximum interval of 24 months.*

The lowest of either the composite Compliance or CRA rating will dictate the examination frequency schedule for the institution. Compliance and CRA examinations will not be conducted independently of each other without prior approval of the Regional Manager. The examination frequency schedule sets the maximum allowable number of months between examinations. This schedule is not meant to preclude DCA Regional Managers and Field Office Supervisors from scheduling examinations earlier if circumstances warrant the acceleration of the examination date.

## OBJECTIVES OF THE EXAMINER IN THE COMPLIANCE EXAMINATION

There are several objectives in the examination of a financial institution. These center around improving the overall performance of all state nonmember financial institutions. The philosophy of examiners should be to assist institutions to help themselves improve their performance. This is accomplished by examiners focusing on operations that pose the most risk to the institution, its depositors, and the public and by emphasizing the management and program components of the rating. In addition, a critical aspect of examination philosophy is for examiners to maintain ongoing communication with financial institution management throughout the examination.

**OBJECTIVES  
OF THE  
EXAMINER IN  
THE  
COMPLIANCE  
EXAMINATION  
(cont'd)**

To attain these goals of improving financial institution performance, examiners should provide institution management appropriate information for improving their compliance program.

This information can take a variety of forms, such as recommending:

Improvement of internal control procedures

Examiners can recommend a secondary review of documentation or the creation of checklists so that loan secretaries may verify that files contain required disclosures.

Enhancement of training

Examiners can recommend that management implement a cross training program for personnel to ensure all employees are knowledgeable of the various consumer protection and fair lending laws and regulations.

Balancing Duties

Examiners can recommend that compliance duties be delegated to persons with time to adequately administer the compliance program. This is especially critical in an institution where one officer is assigned a multitude of responsibilities and does not appear to have sufficient time to adequately administer the compliance program.

This assistance is best provided by examiners sharing their experience and knowledge of successful compliance/CRA programs with financial institution management. The examiner's efforts will help improve the financial institution's compliance posture and help prevent future violations from occurring. In addition, examiners are responsible for providing guidance to institution management regarding the various consumer and fair lending laws and regulations, and any changes to the regulations between examinations.

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**GENERAL  
EXAMINATION  
PROCEDURES  
AND  
CONSIDERA-  
TIONS**

To maximize examiner time and resources, proper examination preparation and planning is essential. Examiners should be aware of the tools and resources available to set the examination scope, conduct the examination, and provide guidance to financial institution management and personnel. Examiners will conduct compliance and CRA examinations simultaneously and for this reason the procedures described below for Scope and Conducting an Examination cover both compliance and CRA examinations.

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**GENERAL  
EXAMINATION  
PROCEDURES  
AND  
CONSIDERA-  
TIONS (cont'd)****Scope**

The examiner should establish the scope of the examination based on potential problem areas. This can be accomplished by assigning a hierarchy of risk to the areas reviewed when ascertaining regulatory compliance in state nonmember financial institutions. The process and procedures for determining the areas of risk for an institution will vary by institution. It is the examiner's responsibility to make an independent analysis of the information made available from both FDIC sources and the financial institution during Pre-Examination Planning (PEP), to determine which areas to emphasize during the current examination.

These determinations may be made based on previous examination findings and whether the institution has an adequate internal audit program or strong review policies and procedures. Where the Examiner-in-Charge (EIC) determines strong controls and procedures exist, a limited scope review of other areas may be conducted.

To set the initial scope of the examination, the EIC will review a variety of information during PEP to determine the level of review for the on-site portion of the examination. A sample of the information to be considered when setting the scope includes:

The financial institution's historical record of compliance, including such items as:

- Violations cited in previous examinations
- Compliance program (strengths and weaknesses)
- Audit and internal control program and procedures

Program deficiencies identified during the previous examination and the institution's corrective actions

The development of any new loan or deposit products or any changes in the portfolio mixes

Senior management changes, especially the compliance officer

Consumer complaints

*NOTE: The examiner may wish to review an area covered by a complaint, even though the complaints were resolved satisfactorily, to ensure that appropriate controls are in place.*

Number and types of branch locations

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**GENERAL  
EXAMINATION  
PROCEDURES  
AND  
CONSIDERA-  
TIONS (cont'd)****Multi-Branch  
Institutions**

In general, when examining a financial institution with multiple locations, various offices should be selected for review while taking into account such factors as:

Locations where credit decisions are made

Types of services and or products offered at various locations

Uniformity of forms

Uniformity of procedures and controls imposed throughout the financial institution's system

Location of key personnel

Location of records needed to determine compliance with applicable laws and regulations

Existence of any outstanding consumer complaint that can only be investigated by visiting a particular office

Branches being independent to make decisions or whether all decisions and actions are centralized

Ability of branch officers to approve or deny credit applications and originate loans and accompanying paper work or whether all originations occur at one location

Acquisition/establishment of additional/new branch locations

It is even more critical to examine various offices of an institution if each office operates independently. In addition, it is desirable to visit different offices from one examination to the next to ensure operating practices are consistent.

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**Targeting the  
Examination**

Once the examiner has reviewed available information, the decision may be made to target the examination to areas identified as problems or areas having a higher likelihood of having violations.

For example, if the financial institution has a strong record of compliance which includes:

A limited number of technical violations identified at previous examinations

**GENERAL  
EXAMINATION  
PROCEDURES  
AND  
CONSIDERA-  
TIONS (cont'd)**

**Targeting the  
Examination  
(cont'd)**



A strong audit, internal controls, and training program

A secondary review system (to ensure proper Real Estate Settlement Procedures Act (RESPA) and Truth in Lending (TIL) disclosures are provided in real estate loans)

These factors would allow the EIC to perform a limited review of real estate loan disclosures for RESPA and TIL, provided procedures have not changed since the previous examination. If the EIC chooses to perform a limited scope review of disclosures for RESPA and TIL, the reasons must be detailed in the workpapers and discussed with management at the initial meeting or the exit meeting.

Another situation where a limited scope review may be appropriate is when an institution has a history of significant problems in one area, but has a strong record in another area. For example, during PEP, the EIC identifies numerous violations of a significant nature, along with a weak compliance program in the credit application denial process from the previous report of examination, while deposit operations covered by Truth in Savings, Expedited Funds Availability, Electronic Fund Transfers, and Part 329 have strong controls and, historically, had few or no violations in previous examinations. In this situation, the EIC may target the examination and review controls and procedures in the deposit-related area, and if satisfied, reduce the sample size to allow more time for review of credit denials.

Another possible situation that may cause the EIC to target the examination is where an institution has introduced a new home loan credit product since the previous examination. In this instance the examiner may target the new home loan product and perform a limited review of instalment loan products, which have not changed since previous examinations and had not been cited for violations.

Targeting the examination maximizes examiner efficiency and may reduce the on-site examination presence, while emphasizing areas of risk. DCA's resources, manpower and otherwise, are maximized by selecting a small sample of documents to review in areas that a financial institution maintains strong controls and has a history of limited violations while spending this time savings on problem areas.

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### **Examination of Affiliates of State Nonmember Financial Institutions**

The FDIC has authority to examine affiliates of insured state nonmember institutions for compliance with various consumer protection laws and regulations. Accordingly, if in the course of an examination of an affiliate, a violation of an applicable consumer protection law or regulation is identified, it **should** be cited in the Report of Examination. Such reporting is consistent and is mandated by Section 10(b)(5)(B) of the FDI Act, which requires the

**GENERAL  
EXAMINATION  
PROCEDURES  
AND  
CONSIDERA-  
TIONS (cont'd)****Examination of  
Affiliates of State  
Nonmember  
Financial  
Institutions  
(cont'd)**

FDIC to make "a full and detailed report of condition of any insured depository institution or affiliate examined by the Corporation."

Additionally, for those regulations where the FDIC is not the primary enforcement authority, such as the Fair Housing Act and the Equal Credit Opportunity Act, there are statutory requirements to refer applicable violation cases to the Department of Justice or the Department of Housing and Urban Development (HUD). Where there is no statutory mandate, referral decisions, as well as decisions regarding the scope of information to be referred, should be made on a case-by-case basis. The circumstances involved as well as other applicable statutory provisions, such as the Right to Financial Privacy Act, must be considered. Any referral of discovered violations of consumer protection laws and regulations to other Federal Agencies with primary enforcement responsibilities, such as the Department of Housing and Urban Development (HUD), Federal Trade Commission (FTC), Department of Justice (DOJ), the Federal Reserve, etc., should generally be made in a narrative fashion which does not disclose the identity of any individual customer.

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**CONDUCTING  
THE  
EXAMINATION****Communication**

Once the initial scope of the examination has been established and the EIC begins the on-site portion of the examination, the most critical aspect of the examination becomes communication with financial institution management. During the examination, the EIC should discuss, on an ongoing basis, any violations, program deficiencies, or other issues identified. Examiners should keep management informed of both identified strengths and weaknesses of the institution's compliance program and posture throughout the examination.

There should be no issues discussed during an exit or board meeting that have not previously been discussed with management. Examiners should make positive comments to reinforce financial institution management's efforts when a strong compliance program is identified.

Communication between the examination staff, the EIC, the Field Office Supervisor, and the Regional Office staff is also critical to the examination process. The EIC should communicate with the Field Office Supervisor throughout an examination to confirm how the examination is proceeding, and determine if there are any issues that require Formal Consultation with either the Regional or Washington Office. The communication between examiners, the EIC, the Field Office Supervisor, the Regional Office staff including review examiners, and the Community Affairs Staff and the Regional Manager, is important to ensuring clear understanding among all levels of FDIC personnel.

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**CONDUCTING  
THE  
EXAMINATION  
(cont'd)****Scope**

The scope of the examination will be preliminarily established during PEP and will continue to develop as the examiner performs the examination procedures set forth in this manual. As the review of files and financial institution documents proceeds during the examination, the examiner may find the need to limit the review based on reliable procedures and controls in place, or expand the review based on a lack of procedures, controls, presence of violations, or other matters deserving attention.

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**Examination  
Procedures**

This manual is designed to guide examiners step-by-step through the process of examining a financial institution. The manual begins with PEP Procedures, moves to Initial Examination Procedures followed by specific procedures for ensuring compliance with all the regulations for which the FDIC has enforcement responsibility. The manual concludes the examination process with Report Format where specific instructions are detailed for preparing the reports of examination.

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**Community  
Reinvestment  
Act**

Detailed procedures for conducting a CRA examination are contained in the CRA Procedures section of this manual. The ideas discussed throughout this Part such as Communication, Scope, Preparing a Report of Examination, Assigning Compliance Ratings, and Workpapers also apply to CRA examinations and Performance Evaluations.

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**Preparing the  
Report of  
Examination**

The Report of Examination (ROE) is a stand alone document which must fully detail the:

Scope of the examination

Identified violations and other matters of supervisory concern

When violations or other concerns are identified, the examiner should investigate and determine the cause of all violations. This can be done through interviews with institution personnel and management. Determining the cause and extent of a violation or program deficiency is critical to writing the ROE, specifically in preparing the violation pages and in proposing appropriate changes or corrective action to prevent recurrences. Once the investigation of the cause of the violation or concern is complete, the examiner should communicate with management the findings.

**CONDUCTING  
THE  
EXAMINATION  
(cont'd)****Preparing the  
Report of  
Examination  
(cont'd)**

Examiner's findings and recommendations

Financial institution's management responses to findings

Throughout the examination and in the ROE, examiners should, when appropriate, highlight the strengths of a financial institution's compliance program.

Whether conducting an examination or reviewing a report in the Regional Office, the following questions should serve as triggering guides for ensuring the validity of the findings in the ROE:

Does the ROE stand on its own in support of the rating?

For CRA, is the ROE and Public Performance Evaluation in full accordance with the revised regulation, examination procedures, and format?

Does the ROE contain sufficient data to support conclusions, or are you assuming that conclusive evidence may exist in the workpapers?

For ROEs reflecting a significant change in rating from the previous examinations (for example, current Compliance Composite 4, but previously rated Composite 2), are the financial institution's activities which contributed to the new rating described in detail to support the marked change?

Do the underlying workpapers document all conclusions?

Is any of the data in the ROE contradicting?

For each comment or conclusion, has its impact been appropriately determined on all factors contained in the ROE?

Does all related information reconcile?

Do the report comments represent the rating definitions?

Are the financial institution's activities described factually?

Is the ROE void of any personal slants or vague descriptors?

If asked "Why?" after reading each report comment or conclusion, can sufficient data and information be found within the report to answer?

**CONDUCTING  
THE  
EXAMINATION  
(cont'd)****Assigning a  
Compliance  
Rating**

In assigning a rating to a financial institution, the examiner should evaluate how well an institution's management administers its compliance responsibilities. The administration of the institution's compliance, audit, and training programs by management and the oversight provided of these programs by management are critical factors to be considered when assigning the management component of the composite rating.

In addition, when assigning the program component, the examiner should recognize that the program each financial institution uses to ensure compliance with applicable regulations is as individual as each institution. Therefore, it is very rare to find two institutions with the same program and examiners should review each institution's program to determine if the program is sufficient for the institution, and if not, identify the weaknesses and make appropriate recommendations for improvement. A significant factor in determining the viability of any compliance program will be the number, nature, and cause of violations cited at an examination.

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**Workpapers**

Standardized workpapers are required for each examination. The workpapers, like the ROE, should fully support the scope and findings of the examination. The standardized workpapers and instructions are in the Standardized Workpapers Appendix. The workpapers are also available electronically in the automated Report of Examination.

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**EXAMINATION-RELATED  
RESPONSIBILITIES**

Examiners are also responsible for conducting other types of financial institution analysis, for example:

- Visitations
- Investigations
- Community Contacts

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**Visitations**

Examiners are responsible for conducting visitations for reasons such as:

- Ascertaining the compliance posture of newly chartered financial institutions

- Ascertaining the compliance posture of institutions rated composite "3" for compliance

**EXAMINATION-RELATED RESPONSIBILITIES****Visitations  
(cont'd)**

Determining corrective action taken by a financial institution with a composite compliance rating of "4" or "5" since its prior examination or visitation

Determining and reviewing from progress reports and institution information corrective action taken by a financial institution with a composite CRA rating of "Needs to Improve" or "Substantial Noncompliance" since the prior examination or visitation

Ascertaining a financial institution's compliance with a formal or informal enforcement action

Visitations are a means for the FDIC to ascertain the compliance posture or implementation of corrective procedures without conducting a full compliance examination. Visitations are usually targeted to specific areas previously identified as weak. Specific procedures for performing Visitations are located in the Visitation section of this manual.

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**Investigations**

Investigations are conducted by the FDIC primarily for two reasons:

Consumer Complaints  
Fair Lending Complaints

Specific procedures for conducting on-site investigations are contained in the Investigations section of this manual.

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**Community  
Contacts**

Examiners are also responsible for conducting Community Contacts during each CRA examination to determine the financial institution's level of involvement in serving its assessment area. These interviews with members of the community assist examiners in the examination process by providing a balanced view of institution activities. In addition, these contacts provide examiners with information as to the credit needs of the institution's assessment area and the institution's performance in meeting these credit needs.

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